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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 003110

SIPDIS

DEPT FOR EUR/RUS, FOR EEB/ESC/IEC GALLOGLY AND WRIGHT
EUR/CARC, SCA (GALLAGHER, SUMAR)
DOE FOR FREDRIKSEN, HEGBORG, EKIMOFF

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TAGS: EPET ENRG ECON PREL RS

SUBJECT: EXXONMOBIL: CAUTIOUS ON SAKHALIN 1 FUTURE,
WORRIED ABOUT SSL, DISAPPOINTED WITH KASHAGAN

REF: A. ASTANA 2025

1B. MOSCOW 2855

1C. MOSCOW 821

1D. 07 MOSCOW 4669

Classified By: Ambassador John R. Beyrle for Reasons 1.4 (b/d)

SUMMARY

11. (C) In an October 20 meeting with the Ambassador, Neil Duffin (protect), President of ExxonMobil Development Company, told the Ambassador that he did not believe the Sakhalin 1 consortium would be able to sell gas to China (ref D) and expressed concern about GOR interference with the consortium's budget. In that regard, he said the company is carefully managing the consortium in order to avoid the fate of Sakhalin 2, taken over by Gazprom following GOR pressure. Duffin said ExxonMobil is very concerned about the impact of the "Strategic Sectors Law" (SSL, ref C), which appears to give the government the ability to take oil and gas fields it determines to be "strategic" after a company has invested effort and money into exploring it. Duffin also expressed disappointment with progress on the Kashagan project in Kazakhstan (ref A), saying that costs had more than tripled to a projected \$27 billion with production delayed from 2009 to 2013. End summary.

SAKHALIN 1

12. (C) Neil Duffin (protect), President of ExxonMobil Development Company (and a former head of ExxonMobil Russia), told the Ambassador in an October 20 meeting that he is concerned that the newly constituted "Authorized State Body" (ASB), the governing board for the ExxonMobil-led Sakhalin 1 project, is going to hamper the project's successful continued development. According to Duffin, two new members of the ASB, Deputy Energy Minister Stanislav Svetlitsky and Energy Ministry Deputy Director for Oil and Gas Vitaly Karaganov, are preventing approval of funds needed to maintain the project's 200,000 barrels per day of oil production. He said ExxonMobil has doubts about their motives.

13. (C) Duffin added that \$500 million has been invested thus far without an approved budget and ExxonMobil is concerned about its exposure if the impasse isn't resolved. Duffin indicated that other ASB members, including from the Ministry of Finance and from the regional government, are reasonable

and play a productive role. Unfortunately, according to Duffin, Svetlitsky and Karaganov have the final say on behalf of the GOR on Sakhalin 1.

¶ 14. (C) Duffin said ExxonMobil is also concerned by demands from Gazprom that Sakhalin 1 gas be sold in greater quantities to Gazprom at an unacceptably low price. Most of the gas from the project is currently re-injected to maintain pressure for oil production, with small quantities (about 140 million cubic meters per year) sold to Gazprom at an acceptable price of \$70 per thousand cubic meters. Duffin said ExxonMobil is trying hard to reach a compromise with Gazprom, which would like more gas from the project, but wants to pay an unacceptably low price of just \$30 per thousand cubic meters. He added that China is willing to pay a very attractive price for the gas, but said sales to China were unlikely to occur given GOR and Gazprom opposition.

¶ 15. (C) Duffin stressed that the project will have to be "carefully managed" to avoid the fate of Sakhalin 2, the neighboring project formerly run by Shell, which had to sell a majority stake to Gazprom under trumped-up pressure from environmental authorities. He described the various negotiations related to the future of Sakhalin 1 as "very complicated" and involving "a lot of politics." He expressed hope that state-owned Rosneft, which owns 20% of the Sakhalin 1 and which he said has been a "pretty good partner on the whole," will help protect the project from capricious government attacks.

¶ 16. (C) Duffin added that ExxonMobil is making the case to Russian political leaders that the company is here for the

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long-term, and is prepared to make substantial job-creating investments in Sakhalin infrastructure. He maintained that the economics of future production from Sakhalin 1 are sound even in the current oil price environment, as the project was launched in the era of \$30 per barrel oil.

STRATEGIC SECTORS LAW

¶ 17. (C) Duffin said he is "hugely worried" about the Strategic Sectors Law (SSL, ref C), which restricts foreign ownership in sectors declared "strategic," including certain oil and gas reserves. He was confident that the law would not be applied retroactively, but was concerned that related amendments to the subsoil law may create uncertainty regarding oil and gas sector investments going forward. He explained that currently, for example, if ExxonMobil invests in exploring a field and discovers a huge deposit, the government could "take it away" by declaring it strategic, only compensating ExxonMobil for its expenses plus 50% -- "so why would we waste our time?"

¶ 18. (C) Duffin said he will address the issue at a meeting of the Foreign Investment Advisory Council (FIAC) in which he represents energy sector investors in Russia. (Note: The FIAC was set up in the 1990's to allow major foreign investors an opportunity to advise the GOR on relevant economic policies. End note.) He hopes the GOR will relax the rules for foreigners partnered with state-owned companies, such as Gazprom or Rosneft.

KASHAGAN, BTC, TURKMEN GAS

¶ 19. (C) Duffin expressed great frustration with mismanagement by Agip (a wholly-owned subsidiary of Italy's ENI) of the Kashagan consortium (ref A) in Kazakhstan, in which ExxonMobil is a partner. He confirmed that Agip has been removed as the operator, but said it will still complete phase 1. He called Agip's management "a total disaster,"

with "fundamentally flawed" engineering and project design that will cost many years of delays and billions of dollars. He said production from the project has now been pushed back from 2009 to 2013 and costs have escalated from \$8 billion to a projected \$27 billion.

¶110. (C) Duffin said transportation of oil out of Kazakhstan remains a major hurdle but he was hopeful that the CPC pipeline expansion would move forward (ref B). An expanded CPC and an expansion of BTC using more compression should help export much of the additional expected crude out of Central Asia. He added that Azerbaijan would like to add an entirely new line alongside BTC (and perhaps also alongside a gas pipeline to handle Azeri and Turkmen gas), but that such a project "would be a huge effort."

¶111. (C) Commenting the recent announcement of the confirmation of significant gas deposits in Turkmenistan, Duffin said there was no question the country had substantial gas reserves. He said Turkmenistan, however, is a "tough place to work" and questioned the export options, noting that Turkmen gas is far from markets and all of the potential routes out pose numerous, significant challenges.

COMMENT

¶112. (C) A declining oil price and a collapsing financial sector could offer some hope that the GOR will renew its push for economic reforms, including increased incentives in the oil and gas sector. However, it is equally plausible that these trends will stoke the tendency of the Russian state toward greater "control" of the sector. End comment.

BEYRLE